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8 UNITED STATES BANKRUPTCY COURT
9 CENTRAL DISTRICT OF CALIFORNIA, SANTA ANA DIVISION
10

11 In re:
12 MORGAN DREXEN, INC.
13 Debtor.

Case No. 8:15-bk-12278-CB
Chapter 7

14 JEFFREY I. GOLDEN, Trustee,

Adv. No. _____

15
16 Plaintiff,

ADVERSARY COMPLAINT FOR:

1) BREACH OF FIDUCIARY DUTY

2) MISMANAGEMENT

**3) WASTE OF CORPORATE
ASSETS; AND**

4) NEGLIGENCE.

17 v.
18 DAVID L. WALKER, an individual;
and RITA AUGUSTA, an individual.

19 Defendants.
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JURY TRIAL DEMANDED.

1 Plaintiff JEFFREY I. GOLDEN (“Trustee”) alleges as follows:

2 1. On April 30, 2015, the Debtor filed a voluntary petition for relief
3 under Chapter 7 of the Bankruptcy Code and Jeffrey I. Golden was appointed
4 Chapter 7 Trustee.

5 2. This is an adversary proceeding seeking damages pursuant to 28
6 U.S.C. Sections 157 and 1334 and Fed.R.Bankr.P. 7001(1). Trustee is the Chapter 7
7 Trustee of the bankruptcy estate of MORGAN DREXEN, INC. ("Morgan") and
8 brings this action solely in that capacity on behalf of the estate.

9 **PARTIES**

10 3. At all times mentioned herein, Morgan was a California
11 corporation, qualified to do business and doing business in the State of California.
12 Morgan filed a petition under Chapter 7 of Title 11 of the United States Code on
13 April 30, 2015 (the “Filing Date”) in this Court that initiated this Bankruptcy Case.

14 4. David L. Walker (“Walker”) is an individual who was the Chief
15 Financial Officer of Morgan from 2009 until 2015. Walker resides in Mission Viejo,
16 California.

17 5. Rita Augusta (“Augusta”) is an individual who was the Chief
18 Operations Officer of Morgan from May 2009 until April 2015. Augusta resides in
19 Tustin, California.

20 **JURISDICTION AND VENUE**

21 6. This adversary proceeding arises under title 11, or arises in or is
22 related to the Bankruptcy Case, within the meaning of 28 U.S.C. Section 1334(b).
23 This Court therefore has jurisdiction over this adversary proceeding pursuant to 28
24 U.S.C. sections 157 and 1334.

25 7. This adversary proceeding is not a core proceeding and is before
26 this Court pursuant to 28 U.S.C. section 157(c). Plaintiff does not consent to having
27 the Bankruptcy Court enter final judgment in this matter.
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1 8. Venue is proper in this district pursuant to 28 U.S.C. section
2 1409(a).

3 9. Walker and Augusta (collectively, “Defendants”), and each of
4 them, are subject to the jurisdiction of this Court. All of the acts or omissions alleged
5 herein took place in this district.

6 **GENERAL ALLEGATIONS AND FACTUAL BACKGROUND**

7 **A. Summary.**

8 10. This case is about the failures of the Defendants, former officers,
9 employees and/or directors of Morgan, to appropriately adjust Morgan’s business
10 model after significant changes to the law.

11 11. In 2010, the Federal Trade Commission (“FTC”) enacted
12 changes to the Telemarketing Sales Rule (“TSR Amendment”), which banned
13 advanced fees for debt settlement practices. At that time, Morgan’s existing business
14 model clearly violated the TSR Amendment because Morgan charged its customers
15 up-front fees for their debt settlement practices. Defendants should have
16 appropriately modified Morgan’s business model to comply with the TSR
17 Amendment, or should have pursued selling the 30,000 consumer files that were
18 active at the time of the TSR Amendment and not subject to the TSR Amendment.

19 12. Instead of pursuing either option to continue in business or sell
20 the business following the adoption of the TSR, Defendants instead chose a business
21 strategy that caused all of the value of Morgan’s business to be lost. Defendants
22 adopted a business strategy of claiming that up-front fees paid by clients were being
23 charged in exchange for bankruptcy services, rather than for debt settlement services.
24 The purported changes to Morgan’s business model were illusory – Morgan
25 continued to provide the same debt settlement services when retained, as clients
26 pursuing bankruptcy as a means of resolving their debts would not also pursue debt
27 settlement services. Defendants did not exercise appropriate business judgment in
28

1 choosing this course of action and did not obtain advice from lawyers or other experts
2 that the new business strategy would comply with the TSR.

3 **B. Morgan's Business Model.**

4 13. Morgan was founded in or around March 2007 by Walter J.
5 Ledda ("Ledda"), who acted as Morgan's President and Chief Executive Officer
6 throughout Morgan's existence.

7 14. At the time Morgan was founded, many state regulations
8 governing the debt relief industry provided an exemption for attorneys performing
9 debt relief services.

10 15. Morgan's business model was simple – Morgan contracted with
11 various attorneys and law firms throughout the United States, who in turn would
12 contract directly with consumers looking for debt relief services. The consumers
13 would pay an up-front fee directly to the attorneys in advance of any debt relief
14 services being rendered. The attorneys then paid the majority of the up-front fees to
15 Morgan, who performed the debt relief services on behalf of the consumers. The
16 attorneys would retain only a small portion of the up-front fees received from
17 consumers.

18 **C. The TSR Amendment and Morgan's Response**

19 16. In October 2010, the FTC initiated the TSR Amendment to,
20 *inter alia*, prohibit debt relief companies like Morgan from receiving up-front fees
21 before any debt relief services were performed. Importantly, the TSR Amendment
22 did not exempt attorneys performing debt relief services.

23 17. Around the time of the TSR Amendment, Morgan purportedly
24 changed its business practice. Instead of having its affiliated attorneys provide
25 consumers with one contract for debt relief services, Morgan altered its practice so
26 that its affiliated attorneys would provide consumers with two contracts – one for
27 debt relief services and one purportedly for bankruptcy-related services (the "Revised
28 Model").

1 18. The Revised Model was created to make it appear as though the
2 up-front payments being charged to consumers were related to the bankruptcy-related
3 services purportedly to be performed by the attorneys, and not for the debt relief
4 services. The Revised Model was a mere subterfuge, because it would never make
5 sense for a consumer to pursue debt relief services (for which no up-front fee could
6 be charged) and bankruptcy-related services (for which an up-front fee could be
7 charged) simultaneously. Indeed, one of the principal goals of debt relief services is
8 to avoid filing bankruptcy. If a consumer was willing to pay an up-front fee for
9 bankruptcy services and pursue that course at the outset, there would be no need for
10 debt relief services because the consumers' debts would be handled in the
11 bankruptcy.

12 19. Prior to the effective date of the TSR Amendment, Defendants
13 had two reasonable options: (a) change Morgan's business model in a manner that
14 would comply with the TSR Amendment, or (b) sell Morgan's customer portfolio to
15 another company who would comply with the TSR Amendment.

16 20. On the effective date of the TSR Amendment, Morgan was
17 handling approximately 30,000 active consumer files that were not subject to the
18 TSR Amendment. If Morgan had attempted to sell those files in 2010, the sales price
19 would have been in excess of \$3,000,000.

20 21. Instead of pursuing either of these options, Morgan instituted the
21 Revised Model without obtaining any definitive legal advice confirming that the
22 Revised Model would comply with the TSR Amendment, and without properly
23 exercising their independent business judgment on behalf of Morgan.

24 22. Until the filing of the bankruptcy petition in this case,
25 Defendants and the other directors and officers of Morgan had custody and control of
26 Morgan's affairs, finances, and documents. Until the Trustee was able to obtain
27 control and conduct his own review of these affairs, finances and documents he was
28 not able to discover the misconduct of Defendants in connection with the business

1 model adopted by Morgan. Accordingly, the statute of limitations on claims asserted
2 herein did not commence until the Trustee discovered such wrongdoing.

3 **D. Defendants' Improper Payments to Ledda**

4 23. During the year prior to Morgan's bankruptcy filing, Defendants
5 paid, or authorized Morgan to pay, Ledda at least \$895,000 in the form of payroll
6 transfers, personal expense payments and the payment of personal legal expenses.

7 24. None of these expenses were legitimate expenses of Morgan and
8 they should not have been approved and paid. Defendants failed to exercise
9 appropriate oversight to prevent such improper payments.

10 25. The Trustee has only recovered \$200,000 of such amounts, with
11 approximately \$695,000 remaining outstanding.

12 **FIRST CLAIM FOR RELIEF**

13 (Breach of Fiduciary Duty – Against Walker and Augusta)

14 26. Trustee realleges and incorporates herein by this reference the
15 allegations of paragraphs 1 through 23, inclusive, of this Complaint.

16 27. As officers and/or directors of Morgan, Defendants owed
17 Morgan fiduciary duties to act in the best interest of Morgan.

18 28. Defendants had the duty to exercise due care and diligence in the
19 management and administration of the affairs of Morgan and in the use and
20 preservation of its property and assets; the duty to exercise due care and diligence to
21 ensure that Morgan's business model complied with applicable laws; the duty of
22 loyalty to put the interests of Morgan above their own financial interests and above
23 the financial interests of other officers, directors and employees of Morgan, including
24 Ledda; and the duty of candor, including full and candid disclosure of all material
25 facts related thereto. Defendants' misconduct involves negligent or knowing
26 violations of their duties as directors, officers and/or managing agents of Morgan, and
27 the absence of good faith on their part, which Defendants were aware or should have
28 been aware, posed a risk of serious injury to Morgan.

1 29. To discharge these duties, Defendants were required to exercise
2 reasonable and prudent supervision over the management, policies, practices,
3 controls, and financial and corporate affairs of Morgan. By virtue of this obligation
4 of ordinary care and diligence, Defendants were required, among other things, to:

5 a. manage, conduct, supervise, and direct the employees,
6 businesses and affairs of Morgan in accordance with laws, rules and regulations, so
7 as to avoid damage to Morgan's interests, including changing Morgan's business
8 model to comply with changes in the law;

9 b. neither violate nor knowingly or recklessly permit any
10 officer, director or employee of Morgan to violate applicable laws, rules and
11 regulations, and to exercise reasonable control and supervision over such officers and
12 employees; and to ensure the prudence and soundness of policies and practices
13 undertaken or proposed to be undertaken by Morgan; and

14 c. not authorize, ratify, approve, facilitate or fail to rectify
15 unearned, excessive and unapproved compensation, salaries or payments to
16 employees, officers and directors of Morgan, including Ledda.

17 30. By reason of the conduct alleged herein, Defendants violated
18 their fiduciary duties to Morgan of care, loyalty, reasonable inquiry, oversight, good
19 faith and proper supervision.

20 31. As a direct and proximate result of the conduct of Defendants,
21 Morgan has sustained general, special and consequential damages in an amount not
22 yet fully ascertained but within the jurisdiction of this Court, the full amount of
23 which will be proven at trial.

24 WHEREFORE, Trustee prays for judgment as hereinafter set forth.

25 **SECOND CLAIM FOR RELIEF**

26 (Mismanagement – Against Walker and Augusta)

27 32. Trustee realleges and incorporates herein by this reference the
28 allegations of paragraphs 1 through 31, inclusive, of this Complaint.

1 33. By the actions alleged herein, Defendants' mismanaged
2 Morgan's affairs and abandoned and abdicated his responsibilities and duties with
3 regard to prudently managing the assets and business of Morgan.

4 34. As a direct and proximate result of Defendants' conduct,
5 Morgan has sustained general, special and consequential damages in an amount not
6 yet fully ascertained but within the jurisdiction of this Court, the full amount of
7 which will be proven at trial.

8 WHEREFORE, Trustee prays for judgment as hereinafter set forth.

9 **THIRD CLAIM FOR RELIEF**

10 (Waste of Corporate Assets – Against Walker and Augusta)

11 35. Trustee realleges and incorporates herein by this reference the
12 allegations of paragraphs 1 through 34, inclusive, of this Complaint.

13 36. By engaging in the wrongdoing alleged herein, Defendants
14 wasted corporate assets by improperly utilizing and misappropriating corporate
15 assets, damaging the goodwill and reputation of Morgan, exposing Morgan to civil
16 liability and causing Morgan to become insolvent and bankrupt, among other things,
17 for which they are liable to Morgan.

18 37. As a direct and proximate result of Defendants' conduct,
19 Morgan has sustained general, special and consequential damages in an amount not
20 yet ascertained but within the jurisdiction of this Court, the full amount of which will
21 be proven at trial.

22 WHEREFORE, Trustee prays for judgment as hereinafter set forth.

23 **FOURTH CLAIM FOR RELIEF**

24 (Negligence – Against Walker and Augusta)

25 38. Trustee realleges and incorporates herein by this reference the
26 allegations of paragraphs 1 through 37, inclusive, of this Complaint.

27 39. As officers, directors and/or managing agents of Morgan,
28 Defendants owed a duty to Morgan to exercise due care and reasonable diligence in

1 the performance of their duties as officers, directors and/or managing agents of
2 Morgan.

3 40. Defendants negligently, carelessly, recklessly and unlawfully
4 performed and breached their duties owed to Morgan by failing to exercise
5 reasonable and prudent supervision over the management, policies, practices, controls
6 and financial and corporate affairs of Morgan.

7 41. As a direct and proximate result of Defendants' conduct,
8 Morgan has sustained and will sustain general, special and consequential damages in
9 an amount not yet fully ascertained but within the jurisdiction of this Court, the full
10 amount of which will be proven at trial.

11 **WHEREFORE**, Trustee prays for judgment as follows:

12 1. For judgment against Defendants for general, special and
13 consequential damages according to proof and interest thereon;

14 2. For Morgan's costs of suit and attorneys' fees according to
15 proof; and

16 3. For such other and further relief as the Court may deem proper.

17 DATED: January 26, 2018

18 SHEPPARD, MULLIN, RICHTER & HAMPTON LLP
19

20 By

/s/ Steven B. Sacks

21 STEVEN B. SACKS

Attorneys for Plaintiff

22 JEFFREY I. GOLDEN, Chapter 7 Trustee of
23 the bankruptcy estate of MORGAN DREXEN,
24 INC.
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JURY TRIAL DEMAND

Plaintiff hereby demands a trial by jury of all claims so triable alleged
herein.

DATED: January 26, 2018

SHEPPARD, MULLIN, RICHTER & HAMPTON LLP

By /s/ Steven B. Sacks
STEVEN B. SACKS
Attorneys for Plaintiff
JEFFREY I. GOLDEN, Chapter 7 Trustee of
the bankruptcy estate of MORGAN DREXEN,
INC.